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FOREIGN DIRECT INVESTMENT IN JAPAN

Summary

In recent years more and more foreign companies have expressed an interest in inaugurating or expanding investment activities in Japan, the world's second-largest market and one with comparatively steady growth in domestic demand. Yet despite this interest and the Japanese government's initiatives to improve the investment climate, foreign direct investment in Japan remains relatively invisible when compared to investment opportunities in other industrialized nations.

Among the steps either implemented or under consideration by Tokyo in response to foreign investors' requests as well as Washington's strong suggestions during last year's Structural Impediments Initiative talks are the relaxation of investment regulations and the expansion of loan offerings and tax exemptions. Some concessionary loan rates and information services have been available for several years. Plus, liberalization measures instituted in the 1970s and in 1980 as well as this year have lowered the institutional barriers to foreign direct investment in Japan.

With changes in investment laws and regulations American investors, and, in turn, Washington trade negotiators, have begun to pay more attention to indirect factors, such as the high cost of land, labor shortages, the distribution system and business practices or other social and cultural behaviors that influence the investment climate. Critics say, for example, that Japanese corporate cross-shareholding practices stifle merger and acquisition transactions, especially by foreign investors.

Increasingly, American corporate executives interested in investing in Japan are making more of an effort to meet the

demands of the Japanese marketplace, such as high quality, prompt delivery, after-sales service and long-term business relations. In addition to establishing a branch office or a joint venture firm in Japan, many successful foreign investors there also have incorporated certain Japanese business practices. Some also have located research and development facilities there to deal with specific market requirements. These efforts by investors combined with Tokyo's promotion campaign may begin to contribute to increased investment inflows.

Trend of Foreign Investment in Japan

Determining the extent of foreign direct investment in Japan from official sources is difficult because one of the two principal sources does not trace withdrawals by foreign investors and the other does not reflect domestic investment by the Japanese subsidiaries of foreign companies. Ministry of Finance statistics (one of the two main sources) deal only with new investment transactions, including the expansion of existing ventures; these data, however, do not record withdrawals by foreign investors. Foreign investors that take 10 percent or more of a position in a Japanese company are required by the Foreign Exchange and Foreign Trade Control Law to report such transactions to the Finance Ministry; the regulation applies to firms capitalized at or above a specified level, but, since almost all foreign direct investments are in firms that meet the criteria, coverage is fairly complete. Every six months the Finance Ministry lists the number of cases and the value of equity held according to investor nationality and by industrial sectors.

The other source of foreign investment data is found in the balance-of-payments sheet published monthly by the Bank of Japan and based on International Monetary Fund guidelines. BOP information includes cross-border capital flows both inward and outward for direct as well as portfolio investment. (The latter covers equity and other transactions where effective ownership is not a dimension of the relationship.) In terms of foreign direct investment in Japan, transactions that count as inward, or positive flows, include equity shareholding by foreign investors as well as long-term lending to foreign subsidiaries or branch offices from overseas creditors. Outward flows, conveyed by negative signs, include the full or partial sales of foreign investors' holdings in their Japan-based subsidiary to either Japanese companies or other foreign subsidiaries in Japan. Payment of long-term loans to overseas creditors also is regarded as an outward, or negative, flow.

While MOF's investment figures are compiled at the time that firms notify the ministry of their intention to buy or obtain a loan or bonds, the balance-of-payments data are collected at the time of a transaction. Moreover, investment by Japan-based foreign subsidiaries shows up in MOF's data, but the balance of payments does not include such transactions since they are not accompanied by a cross-border transaction. However, MOF's data do not include long-term loan repayments to overseas creditors, which is reflected in the

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balance of payments. These differences explain why each source is important to consider and why neither is sufficient alone.

Table 1 shows both reported investments and net transactions from data compiled by the Ministry of Finance and the Bank of Japan. During the last decade new investment expanded almost sixfold in both number of cases and total value of equity investment. While the total number of cases consistently increased during the last decade with the exception of 1985 and 1986, total annual values have followed a less predictable path, especially since 1986. For example, the average equity value acquired in 1988 was $608,000, which was almost double 1989's average of $344,000. The fluctuations are explained, in part, by the sensitivity to outliers in investment values; one single large-scale transaction can have a big impact on the total value of annual transactions.

Table 1: Trends in Foreign Direct Investment in Japan, FY 1951-FY 1990

(number of cases and millions of dollars)

Fiscal Year	Equity Capital		Loans and Bonds		Total		Net Transaction Amount
	Cases	Amount	Cases	Amount	Cases	Amount	
1951-80	8,826	$2,979	n.a.	n.a.	8,826	$2,979	n.a.
1981	919	432	n.a.	n.a.	919	432	$151
1982	1,052	749	n.a.	n.a.	1,052	749	492
1983	2,363	813	n.a.	n.a.	2,363	813	403
1984	3,685	493	n.a.	n.a.	3,685	493	14
1985	3,322	780	48	$150	3,370	930	705
1986	3,045	760	34	180	3,079	940	443
1987	3,912	1,453	34	761	3,946	2,214	463
1988	4,236	2,576	32	667	4,268	3,243	-287
1989	5,638	1,941	50	919	5,688	2,860	-286
1990	5,902	2,585	37	193	5,939	2,778	1,124
Cumulative Total	42,900	15,561	235	2,871	43,135	18,432	n.a.

Source: Ministry of Finance and Bank of Japan

Although new investment transactions generally have increased, as represented by MOF's statistics, the net inflow shown in the far right column of Table 1 did not always increase. Despite notice having been filed for more than $2 billion worth of new foreign investment, including loans and bonds, each year since 1987, net transactions in 1988 and 1989 reflected an outward, negative, flow. This stemmed in part from large-scale capital withdrawals by General Motors Corp., Chrysler Corp. and Honeywell, Inc. in this period.

U.S. investors represented the largest single group of foreign investors in Japan on a cumulative basis but dropped to second place in last year's annual total when investors from the Netherlands put in more money in more transactions than any other foreign investors (see Table 2). On a cumulative basis U.S. investors hold 46.5 percent of the total book value of reported investment. American investors also lead in the number of cases with 19.3 percent of

Table 2: Foreign Direct Investment in Japan by Country, FY 1989-FY 1990*

(in millions of dollars)

	FY 1989			FY 1990			Cumulative March 31, 1991		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
United States	727	$1,642	57.4%	672	$664	23.9%	8,353	$8,573	46.5%
Canada	83	35	1.2	53	142	5.1	725	329	1.8
Netherlands	735	248	8.7	729	734	26.4	2,862	1,464	7.9
Switzerland	403	87	3.1	364	142	5.1	2,[illegible]42	1,157	6.3
West Germany	365	144	5.0	345	259	9.3	2,373	950	5.2
United Kingdom	495	81	2.8	507	54	1.9	3,733	652	3.5
France	388	25	0.9	438	74	2.7	2,431	301	1.6
Other Europe	193	40	1.4	206	98	3.5	1,984	475	2.6
Hong Kong	445	63	2.2	384	62	2.2	4,395	515	2.8
Japan**	333	198	6.9	389	231	8.3	3,780	2,082	11.3
Other	1,521	297	10.4	1,852	317	11.4	9,857	1,933	10.5
Total	5,688	2,860	100.0	5,939	2,778	100.0	43,135	18,432	100.0

*Approval basis. Data exclude disinvestments.
**Investments by Japanese firms with significant foreign participation.

Source: Ministry of Finance

the total. Hong Kong investors ranked ahead of individual European countries in cumulative transactions, holding 10.1 percent share of the total number of cases but were far down the list on amounts invested with 2.8 percent of book value. The average American investment exceeded $1 million, almost twice the Netherlands' average of $511,000. Other averages were $438,000 for Switzerland, $400,300 for Germany, $174,700 for Great Britain, $124,000 for France and $117,200 for Hong Kong. Since U.S. investors entered the Japanese market earlier than other investors, the current American investment value generally is considered to be much higher than the cumulative book value shown in Table 2 because of historically rising prices from the time of the original transactions.

A further indication of the long-term involvement in Japan by U.S. firms is the ranking of 30 U.S.-affiliated companies among the top 50 foreign firms when listed by taxable annual income in 1990; Germany holds second place with six firms, followed by Great Britain with five. But the scale of operation remains small when compared with domestic Japanese companies' taxable income; only IBM Japan Ltd. -- in 17th place -- ranked in the top 100 overall.

Machinery and the chemical industries have been the major draw for foreign investors -- the two industries hold 79.3 percent of total cumulative investment in the manufacturing sector (see Table 3). In manufacturing industries foreign direct investment grew more than 50 percent in FY 1990 over the previous year. The slower growth of investment in the nonmanufacturing sector mainly was caused by a slump of investment in the real estate industry; investment in commerce and retail trade grew by 34 percent.

Despite increasing activity by foreign investors in Japan, the total amount of direct investment remains small compared with Japanese companies' overseas investment and other industrialized countries' acceptance of foreign direct investment. According to the Department of Commerce, the United States, in 1990 alone, accepted $64.4 billion worth of foreign direct investment, which included $51.9 billion invested by U.S. subsidiaries of foreign firms. Of the $64.4 billion U.S. total, Japanese investors provided $20.5 billion. MOF's figures on direct investment by Japanese overseas showed a total of $56.9 billion, of which $26.1 billion was directed to the United States. In comparison, total foreign investment in Japan that same year was $2.8 billion, of which $664 million represented American interests, according to MOF. Viewed in another way, two large-scale transactions by Japanese firms each exceeded the total amount of foreign direct investment in Japan for the period in which they took place. Matsushita Electric Industrial Co., Ltd.'s $6 billion-plus acquisition of MCA Inc. in late 1990 was more than twice the foreign direct investment in Japan for FY 1990. In 1989 Sony Corp. paid more than $3.4 billion to buy out Columbia Pictures Entertainment Inc.; foreign direct investment in Japan for FY 1989 was $540 million less.

Country-by-country comparison of outstanding assets is difficult since most industrialized countries disclose the figures on a current-cost basis rather than using cumulative inflow and outflow figures based on historical costs. Moreover, there is no universal standard of adjustment used to calibrate current values of the outstanding assets. Countries differ, for example, in how they calculate their outstanding overseas assets and the foreign assets in their country, their outstanding debt, and how they adjust for exchange rates, stock market share prices and values of tangible and intangible assets. Nevertheless, a rough comparison is possible. According to MOF's outstanding

Table 3: Foreign Direct Investment in Japan by Industry, FY 1988-FY 1990*

(in millions of dollars)

	FY 1989			FY 1990			Cumulative March 31, 1991		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
Manufacturing	2,066	$1,172	41.0%	2,030	$1,570	56.5%	18,784	$11,771	63.9%
Food	126	17	0.6	74	29	1.0	1,204	312	1.7
Textiles	13	0	0	26	18	0.6	197	69	0.4
Rubber and Leather	34	29	1.0	7	1	0.0	127	77	0.4
Chemicals	194	203	7.1	234	438	15.8	2,451	3,159	17.1
Petroleum	24	8	0.3	59	30	1.1	524	722	3.9
Nonmetallic Mineral Products	8	6	0.2	73	6	0.2	448	148	0.8
Metals	187	40	1.4	125	151	5.4	992	648	3.5
Machinery	1,093	808	28.3	886	806	29.0	10,274	6,176	33.5
Other	387	61	2.1	546	92	3.3	2,567	461	2.5
Nonmanufacturing	3,622	1,688	59.0	3,909	1,208	43.5	24,351	6,661	36.1
Construction	419	9	0.3	366	9	0.3	1,536	90	0.5
Real Estate	121	647	22.6	114	24	0.9	488	818	4.4
Commerce	1,710	544	19.0	2,057	730	26.3	12,878	2,944	16.0
Services	972	138	4.8	1,098	263	9.5	6,619	1,061	5.8
Transportation	149	47	1.7	63	12	0.4	482	139	0.8
Communications	14	23	0.8	13	21	0.8	113	148	0.8
Banking and Insurance	40	180	6.3	64	109	3.9	311	681	3.7
Other	197	100	3.5	134	40	1.4	1,924	780	4.2
Total	5,688	2,860	100.0	5,939	2,778	100.0	43,135	18,432	100.0

*Approval basis. Data exclude disinvestments.

Source: Ministry of Finance

investment figures calculated at the end of each year using a current-cost basis (see Table 4), the gap between Japan's outstanding investment abroad and outstanding foreign investment in Japan has deepened, especially after 1987 when Japanese investors parlayed a stronger yen into more direct investment abroad. While Japanese outstanding investment was just 1.6 times as large as outstanding foreign investment in Japan in 1972, the gap reached 20.5 times as of the end of last year. According to the Department of Commerce, as of the end of 1989 the outstanding U.S. direct investment abroad on a current-cost basis totaled $535.8 billion, or 1.17 times the outstanding foreign investment in this country of $457.6 billion. Similarly, the Bank of England's figure for outstanding overseas investment as of the end of 1989 rang up 1.7 times higher than the outstanding foreign investment in that country. The Bundesbank's statistics for calendar year 1990 showed that Germany's outstanding foreign investment was 2.2 times higher than the outstanding foreign direct investment there. Even taking varying methods of calculation into account, the difference in this international comparison highlights Japan's significant gap between investment assets and debts.

Table 4: Japan's Outstanding Direct Investment Abroad and Outstanding Foreign Direct Investment in Japan, Yearend 1972-90

(in millions of dollars)

Year	Japan's Outstanding Investment Abroad	Outstanding Foreign Investment in Japan	Ratio
1972	$2,574	$1,645	1.6
1975	8,322	2,084	4.0
1980	19,612	3,270	6.0
1985	43,974	4,743	9.3
1986	58,071	6,514	8.9
1987	77,022	9,018	8.5
1988	110,780	10,416	10.6
1989	154,367	9,160	16.9
1990	201,441	9,850	20.5

Source: Ministry of Finance

Some economists reason that the huge gap between Japanese investment overseas and foreign investment in Japan stems from that country's investment-savings imbalance. Japan's domestic savings, especially in the private sector, has exceeded its domestic investment since 1981, allowing the net excess to be invested abroad, although not necessarily in foreign direct investment. If a large proportion of the nation's private foreign asset transactions went into direct investment, there would be a tight link between the investment-savings imbalance and the net flow into foreign direct investment. However, the proportion of the Japanese private sector's foreign direct investment to its total outstanding overseas assets was only 12.1 percent as of the end of 1990. The remainder consisted of loans, bonds and security issues.

In addition to foreign direct investment being only one form of outbound flow, the investment-savings linkages do not explain the gross levels of inbound and outbound investment. The investment-savings imbalance is only one of the factors that contributes to the heavy foreign investment by Japanese firms, the strength of the yen being another. The domestic regulatory framework and international differences in markets have a significant influence on the side of the equation affecting foreign investment in Japan.

Investment Regulation

Japan no longer has any significant regulatory restrictions against foreign investment. Until the early 1970s, though, Tokyo enforced protective regulations on investments out of a concern that domestic industry was weak compared to powerful foreign enterprises. Now, with Japanese industry regarded as one of the strongest in the world, Tokyo has no excuse to maintain restrictive measures on foreign investment. In fact, government ministries have taken steps to open the Japanese market to foreign investors to help pacify overseas criticism and relieve investment frictions that have arisen from the contrast between an overwhelming Japanese presence abroad and a relatively invisible foreign presence in the domestic market.

The original Foreign Investment Law enacted in 1950 aimed to put all kinds of foreign capital flows under the control of the Japanese government. Only a limited amount of foreign direct investment -- that which then was judged as not being in an area in competition with Japanese industry -- was permitted on condition that the foreign affiliates could not send profits to their overseas parent companies. Foreign currency exchange was allowed, as was remittance of profit, starting in 1964. IBM Japan and Coca-Cola Co.'s Japanese subsidiary were established under these early conditions.

As Japan entered the club of industrialized nations, becoming a member of the Organization for Economic Cooperation and Development and the General Agreement on Tariffs and Trade, Tokyo was urged to liberalize its investment regulations in line with international accords. Between 1967 and 1973 Tokyo implemented a package of liberalization reforms; eventually it allowed up to 100 percent foreign ownership in all but 17 industries with prior approval of the government. The Big Three U.S. auto manufacturers, for example, took advantage of the 1971 liberalization measure to gain equity shares in Mitsubishi Motors Corp., Mazda Motor Corp. and Isuzu Motors Ltd.

Further liberalization reforms were enacted in 1980. The Foreign Investment Law was replaced by a Foreign Exchange and Foreign Trade Control Law. Under the new regulation all but four industries -- petroleum, leather, mining and agriculture, forestry and fishery -- were, in principle, open to foreign investors. Even in the four industries where limitations apply, some foreign investment has been allowed, such as in petroleum refining and sales.

Prior notification to the Finance Ministry through the Bank of Japan substituted for the previously required government approval. The government, however, retained the right to object to any foreign investment deemed a possible threat to national security or related interest; that right also could be exercised if a foreign investment was considered able to adversely effect the smooth performance of either the Japanese economy as a whole or an industrial sector related to the projected investment. Tokyo also retained the right to

reject investment from the viewpoint of reciprocity. Washington negotiators at the 1990 Structural Impediments Initiative talks and private investors more generally were not fully satisfied by the 1980 amendment of the investment regulations. They contended that the prior notification and review requirement process was too broad as well as too vague and constituted a de facto government approval mechanism. In essence, the regulation was not much different from the previously applied government approval requirement. The prior notification process also typically caused an unnecessary delay in operations, which discouraged foreign investment in general.

Responding to Washington's complaints, Tokyo amended the 1980 Foreign Exchange and Foreign Trade Control Law at the last regular Diet session, which ended in May; the new framework will be enforced as soon as related regulations are prepared. The new approach requires foreign investors to make only ex post facto reports to the government, except in investments involving the currently restricted four industries and those that might imperil national security or the smooth performance of the Japanese economy. For the convenience of foreign investors Tokyo also promised to issue a broad list of industries exempt from prior notification. In judging the influence on national security or smooth economic performance Tokyo promised to keep its interpretation as narrow as possible. For example, the inclusion of related domestic industries, previously mentioned as a measure for judging the effect on economic performance, was deleted. Japan's newly introduced investment regulations are expected to be equivalent to other industrialized nations' criteria. Although investment in some particular industries -- such as broadcasting, telecommunications, air and marine transport and financial services -- remains under licensing requirements or some other form of government control under separate regulations, legal restrictions on foreign investment as a whole were mostly dismantled by this year's amendment.

Japan's Climate for Foreign Investment

Although most investors in Japan appreciate the recent improvements in foreign investment regulations, social factors and a variety of economic forces still present obstacles to inbound foreign direct investment. In a 1991 survey of more than 1,200 American companies in both the United States and Japan by the American Chamber of Commerce in Japan, respondents pointed out several barriers that they have to surmount when they enter the Japanese market or try to increase their business opportunities there.

Most of the issues raised in the survey also were on the agenda of last year's SII talks between Tokyo and Washington. The principal complaints centered on: the high fixed cost of doing business, especially at the initial stage, mainly because of high land prices or office rent; the difficulties in hiring and keeping personnel because of Japan's tight labor market and a seniority-based pay system that can pose problems for people wanting to change jobs; complicated and unique business practices, such as the distribution system; keiretsu practices in which corporate groups engage in cross-shareholding among members of the group; and a lack of transparency in ministry guidelines and other regulatory measures. Some ACCJ members also complained that the Japanese government provided relatively few incentives, like tax exemptions and financial support, to facilitate inward investment. Despite these complaints, the survey also found that 63 percent of the 340 respondents expect the climate for trade and investment in Japan will continue to improve over the next five years.

High fixed costs - Japan's population and information centers are grouped in metropolitan areas, primarily in the Tokyo area, contributing to tremendously high real estate prices -- especially office rent in Tokyo. Moreover, land prices, on average, have more than doubled in the last five years, in part because of heavy speculation in land (see JEI Report No. 28A, July 20, 1990). Almost two-thirds of American companies answering the ACCJ survey addressed the difficulty of finding a reasonable price for adequate office space in Tokyo or a factory site in industrial areas. Foreign investors planning operations in Japan usually do not expect to show any net profits in the first three to five years because the purchase of real estate or the establishment of an office is such a high fixed cost at the start of the venture.

In response to Washington's requests at the SII talks government officials introduced a land reform package late last year to reduce, or at least to stabilize, land prices by enacting new taxes on land held for speculative purposes, reviewing land-use policies and restricting both banks' and nonbanks' loans for land purchases (see JEI Reports No. 45B, November 30, 1990, No. 47B, December 14, 1990 and No. 5B February 8, 1991). The Japanese government also is preparing to extend no-interest loans to the semi-public sector to construct office buildings for foreign tenants. Revenue from the sale of government-owned stock in Nippon Telegraph and Telephone Corp. will be used for the program, which also will receive guarantees from the Japan Development Bank. Some American- and European-affiliated firms also have begun coping with space problems by introducing to their work place the greater density of Japanese office layouts in which managers and employees work in the same room.

Although the price of industrial sites is relatively expensive even in the countryside, some local governments have acted out of concern for their economies by actively inviting foreign companies, especially high-tech companies, to establish offices and plants in their localities. Since local governments have very little independence from the central government in Japan, the assistance that central government officials can give local authorities is an important factor in attracting foreign investors. The central government is encouraging local government initiatives by planning to enlarge subsidies related to the invitation to foreign investors.

Financial Incentives - The Ministry of International Trade and Industry is planning to introduce a financial and tax incentives program from FY 1992, which starts next April, in a bid to help foreign investors in Japan. The affiliates of foreign-based companies in Japan currently can access government financial assistance through the Japan Development Bank, meeting the same standards that apply to companies headquartered in Japan. In addition to general loans, two categories of special low-interest loans are available for foreign-affiliated firms. One type is set aside for companies engaged in high-tech industries, such as electronics, fine chemicals, new materials, biotechnology or advanced software development. The other type of loan is aimed at encouraging foreign investment that may contribute to a significant increase in Japan's imports. Such investments as wholesale and retail sales are eligible for the latter category. In FY 1990 the Japan Development Bank issued Y23.2 billion ($171.9 million at Y135=$1.00) of special interest loans as well as Y21.8 billion ($161.5 million) of general loans (see Table 5). To facilitate and expand foreign investors' access to the government loans, MITI asked the Japan Development Bank to abolish the sectoral conditions on special loans; all foreign investors will be able to access concessionary loans from FY 1992 regardless of the sector of investment.

Table 5: Japan Development Bank Loans to Foreign-Affiliated Companies, FY 1987-FY 1990

(in billions of yen)

	FY 1987	FY 1988	FY 1989	FY 1990
By Program				
Facilities for Imported Products	Y4.4	Y8.2	Y9.7	Y13.9
Promotion of Direct Investment in Japan	10.6	6.8	5.3	9.3
Other	14.2	21.3	28.9	21.8
Total	29.2	36.3	43.9	45.0
By Country				
United States	17.0	27.4	22.0	23.3
West Germany	8.3	6.0	8.8	11.1
Others	3.9	2.9	13.1	10.6

Source: Japan Development Bank

In the area of tax incentives Japan's tax code currently allows a tax loss carry-forward for an initial five-year period; this span is considered too short for many foreign investors to recover their initial fixed costs. MITI officials intend to extend the tax-exempt period for initial foreign investment as well as to set up more foreign trade zones, or bond zones, from FY 1992 in line with the ministry's promotion program for inward investment. While Tokyo has established the framework for free enterprise zones, only the Naha Airport area on Okinawa has instituted a tax haven program for offshore investment. The imported materials and goods to be assembled or used there have been exempted from already low Japanese tariffs; foreign firms further have been encouraged to set up there, provided their resulting products are reexported, by being allowed a reduction of some local real estate taxes.

Labor shortage - Japan's currently tight labor market reflects a nearly five-year-long economic boom and a long-term demographic trend that shows a continuous decline in the working-age population. Many foreign investors, thus, have faced difficulties in recruiting qualified employees in Japan, especially at the initial stage of their operation. Worsening the situation has been the traditional Japanese practice that leads to expectations of a career-long position within one company; this cuts the chance that middle-aged managers and engineers would shift to other companies, particularly since the seniority-based pay system complicates matters when someone of middle age shifts to a new firm.

The tight labor market, however, is motivating changes that work to the advantage of foreign investors. As the labor market becomes a seller's market, more workers are considering switching jobs in search of better job conditions. The rapid change of Japan's industrial structure also has accelerated changes in the labor force. The Labor Ministry released in September a survey that indicated in 1990 alone 3.17 million workers changed their jobs. This number exceeded last year's total addition of 2.35 million new employees in the work

force. Last year job changes as a ratio of the total employed work force amounted to 5.07 percent. This was up 0.73 percentage point, or 530,000 job-changers, from 1987. Job shifts are found more frequently among younger workers; this suggests that the career-long employment practice, especially the guarantee of a permanent job, is declining as a decisive factor in attracting young workers to a particular firm.

Another factor for changing Japanese workers' attitudes toward jobs is that, as Japanese companies have become globalized, many Japanese workers and their families have experienced living and working abroad where different employment practices take place. In 1990, for example, 57 percent of Japanese companies with 1,000 to 4,999 employees, and 88 percent of those with more than 5,000 workers, posted a number of their employees abroad. Since some of these workers and their families have become accustomed to Western life-styles as well as labor practices, they have fewer difficulties working for a foreign-affiliated company than older, less international, workers might. Moreover, many Japanese workers recently have become more concerned about leisure activities, spending time with their families and even becoming involved in community activities. Some of these employees care more about working conditions, including the length of the workday, than about wages when they judge where they want to work. In this regard foreign-affiliated companies often provide more attractive conditions for their employees. For example, Fuji Xerox Co., Ltd. and IBM Japan have introduced long-term paid leave for their employees engaging in voluntary community activities.

Mergers and Acquisitions - To reduce initial operating costs and lessen the difficulties of recruiting personnel, a corporate merger or the acquisition of an existing firm is considered a suitable way of entering business in many countries. In the United States and Europe, for example, M&A is a tool widely used by foreign investors; of last year's $64.4 billion in foreign direct investment in the United States, $56.8 billion, or 88.1 percent of the total, involved acquisitions with the remainder consisting of green-field investment, according to the Commerce Department. In this country the selling and the buying of corporate ownership are common business practices, facilitated by institutionalized procedures in the security and the banking markets, like takeover bids and leveraged buyouts.

In contrast to the American market, M&A transactions are scarce in Japan. A Japanese security company's 1991 survey indicated that only 311 M&A cases occurred last year in Japan, including Japanese companies' acquisition of Japanese companies as well as foreign firms' acquisition of Japanese companies (see Table 6). In contrast, Japanese firms acquired 440 companies abroad last year. Of the 311 M&A cases in Japan foreign investors were involved in barely 18. Although Japanese overseas M&A activities increased by more than four times between 1985 and 1990, foreign companies' acquisitions of Japanese firms decreased from 26 to 18 during the same period. Since details of the transactions are not fully open to the public, data are not available for the total value of the transactions. Some researchers have estimated from the disclosed transactions that when a Japanese firm acquired a foreign company in 1989 the average value amounted to Y11.2 billion ($83 million). This far exceeded the average value of M&A between Japanese companies, estimated at Y2.2 billion or $16.3 million, as well as foreign firms' acquisition of Japanese companies, put at Y3.6 billion ($26.7 million). It should be stressed that these estimates are rough, since the available samples are too small to analyze or describe the total picture and even a single large-scale transaction can have a great influence on the average value.

Table 6: Number of Mergers and Acquisitions Involving Japanese Firms, 1981-90

Year	Japanese Firms Acquire Japanese Firms	Japanese Firms Acquire Firms Abroad	Foreign Firms Acquire Japanese Firms	Total
1981	122	48	6	176
1985	163	100	26	289
1986	226	204	21	451
1987	219	228	22	469
1988	223	315	17	555
1989	240	405	15	660
1990	293	440	18	751

Source: Yamaichi Securities Co., Ltd.

There are several explanations about why M&A transactions are rare in Japan, especially those that involve foreign investors (see JEI Report 14A, April 6, 1990). Some analysts tie the scarceness to the keiretsu-style practice of Japanese companies engaging in mutual shareholding among members of a corporate grouping. Other analysts focus on not-yet-matured Japanese stock and financial markets where neither M&A techniques nor M&A preventive practices have been developed. Another suggested factor is the general Japanese corporate attitude that tends to regard selling and buying companies as immoral, much like buying or selling a family.

The mutual shareholding practice, in fact, is closely related to a general corporate approach that is hostile to takeovers. When members of a corporate group hold significant amounts of equity in a company, and keep those shares from being traded, outsiders have little opportunity to acquire a majority stake in a firm. Although the average value of a financial keiretsu member held by members of the group adds up to well below 50 percent -- between 12 and 27 percent -- of the total equity (see JEI Report No. 2A, January 12, 1990), it is often large enough to cement ties among member companies. Technically it might be possible for outsiders to buy a majority stake in a certain keiretsu member if sufficiently large takeover partners could unite in a concerted action. In reality, however, any hostile takeover attempt most likely would be blocked by the collective actions of other group members, which would seek to increase their shares to the majority level. Given such circumstances, takeover attempts rarely succeed in Japan without the agreement of existing institutional shareholders. Other analysts also indicate that cross-shareholding functions as a substitute for the defensive measures that work against takeover attempts in other countries, such as stock buy-back plans, the conversion of a public firm into a privately held one, and the issuance of nonvoting stock.

Although the number of M&A transactions remains small in Japan, acceptance of the transaction gradually is growing there. As Japanese corporations become more actively involved in M&A activities abroad, such transactions are losing their immoral taint at home, at least in corporate eyes. For example, Mitsui Bank Ltd.'s 1990 merger with Taiyo Kobe Bank Ltd. was seen as a way of strengthening their collective competitiveness in the face of coming fundamental liberalization of Japan's financial services. Moreover, the Japanese government has supported the acquisition by larger companies of almost bankrupt firms as a rescue measure. Further evidence of a changing outlook is that more

and more brokerages anxious to be more active in mediating transfers of corporate ownership have established M&A divisions. Even family-owned small- and medium-sized firms sometimes use the mediation services of these security companies if the present owners cannot find by themselves an appropriate successor within their family or among acquaintances.

The Japanese government also has begun to improve legal and institutional aspects regarding M&A activities. The first step was made with the December 1990 introduction of a requirement that shareholders with over 5 percent of the total equity of a firm disclose details of the acquisition to authorities (see JEI Report No. 3A, January 25, 1991). Tokyo also has improved measures related to takeover bids since then. Barely three takeover bids occurred prior to the change; three cases have developed in the first half of this year alone.

The Ministries of Finance and of International Trade and Industry are studying further liberalization of the securities markets with the purpose of harmonizing relations with other industrialized economies, including improved transparency as well as protection of investors. Reviews of the Security Exchange Law, the Corporate Law, the Foreign Exchange and Foreign Trade Control Law, the Antimonopoly Law and other related regulations are proceeding in line with the liberalization of the Japanese security market and the promotion of foreign inward investment. Although a quick change in cross-shareholding practices and corporate attitudes hardly is expected in the short-run, legal and institutional improvements in M&A activities may contribute to positive acceptance of M&A transactions by Japanese corporations in the long run. Follow-up talks on the Structural Impediments Initiative also will keep the pressure on Tokyo to follow through on its liberalization and transparency measures. Despite changes in the foreign ownership opportunities in Japan Washington feels more can be done (see JEI Report No. 4B, February 1, 1991).

Japanese Business Practices - For any foreign investor, understanding the business practices in a host country is critical to success. Apart from differences in language and culture many foreign investors have trouble understanding and coping with Japanese business practices. Japanese companies, for example, put a priority on stable and long-term relationships with their business counterparts; this takes time, perseverance and patience for foreign newcomers unfamiliar with the Japanese market. Since severe competition is the rule among enterprises in Japan, customers have very strict expectations. Firms have to be concerned not only about the price of products but about quality, prompt delivery and after-sale services.

Despite the difficulties of understanding and responding to Japanese business practices, some foreign companies have achieved significant success in the Japanese market. Successful companies, in general, accept Japanese business practices as a given factor, rather than as an impediment, and actively adjust themselves to the Japanese ways of business. The 1991 survey by the American Chamber of Commerce in Japan shows that those companies that promote local authority are more successful than those companies with limited autonomy from their overseas parent. Successful companies, the survey indicated, are those that allow their subsidiaries a wider range of decisionmaking powers, including budgeting. They have hired many Japanese executives to manage the company. Some also have established research and development facilities in Japan to develop and design products to meet the specific requirements of Japanese customers. The relatively high standards of Japanese buyers indicate that products made in Japan by foreign-affiliated firms probably could win markets back home and in other countries.

Although the complicated Japanese distribution network has been called a nontrade barrier, some American and European companies have solved the problem by establishing their own sales subsidiaries in Japan and setting up their own distribution market. For example, Bayer AG, which until March 1990 had sold through a Japanese pharmaceutical company's outlets, now has developed its own dealership in Japan. Procter & Gamble Co. contacted several Japanese warehouses to establish its own sales network, independent of traditional Japanese distribution channels. By forging their own distribution linkages, foreign companies can respond more quickly to customers' requests as well as collect more timely market information. Such practices, however, further increase the size of the necessary initial investment and the fixed costs involved in the transaction.

Market information is considered a key to success in the Japanese market. The Japan External Trade Organization provides basic information and advice to foreign investors interested in the Japanese market through its Tokyo headquarters as well as its overseas branch offices. Japanese private business organizations also help foreign investors. For example, Keidanren (the Japan Federation of Economic Organizations) established in 1986 an in-house committee of foreign-affiliated corporations, involving about 50 Japanese subsidiaries of foreign companies. Based on the requests of the Japan-sited foreign affiliates the organization urged the government to improve the import and investment climate in Japan. The committee plans to host a seminar on foreign investment in Tokyo at the end of September inviting over a hundred Japan-based foreign corporate executives and representatives from OECD member countries' embassies. In addition to these official and semi-official moves, a swarm of consulting companies has opened offices in Japan and the United States to advise clients on investing in a gradually opening Japanese economy. It will take some time, though, to observe whether this collection of actions is paying off in greater investment flows.

As Japanese companies have become more deeply involved in overseas operations through trade and investment, they have begun to acknowledge that their relationship with the government and some of their business practices -- which have remained almost unchanged from the days when the Japanese economy was protected closely by the government -- are no longer appropriate for the current economic and political situation. The Japanese business sector can share most of the views raised by Washington at the SII talks on inward investment. The private sector remains concerned that perception of a one-way flow of trade and investment from Japan might cause retaliation against Japanese companies in overseas markets.

Although the current level of investment inflow is low for an economy the size of Japan's, the investment atmosphere is changing. Foreign investors expect improved trade winds as Tokyo continues to dismantle investment controls and expand import and inward investment promotion measures to foreign investors. Whether or not, and to what extent, the amount of inward investment will increase will depend more and more on foreign investors' efforts to cope with Japanese market demands.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

NOTE

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